TOWN AND COUNTY OF NANTUCKET

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TO: Board of Selectmen
Ad Hoc Budget Work Group

FROM: C. Elizabeth Gibson, Town Manager

DATE: November 17, 2009

RE: Solid Waste Enterprise Fund Revenue Options

The Town's solid waste consultant CommonWealth Resource Management (CWRM) has advised that new revenue is necessary in order to resolve the Solid Waste Enterprise Fund's (SWEF) structural budget deficit. The purpose of this memorandum is to outline potential revenue options for the SWEF, and to provide additional information regarding the SWEF deficit.

There are four potential revenue sources for the SWEF:

(1) dedicate additional property tax revenue to the SWEF through an operating override;
(2) implement new user fees;
(3) adjust existing fees to increase revenue; and
(4) make the general fund subsidy to the SWEF permanent by reducing School and Town general fund spending on an ongoing basis.

One of these options, or a combination of these options, could be implemented to cover the revenue deficit within the SWEF.

1. ***Operating Override***

An operating override to Proposition 2 ½ for the SWEF was first approved in 1999, and a second operating override was approved in 2006. In fiscal 2011, these operating overrides will provide approximately $2.85 million in revenue for the SWEF.

There is a fundamental difference between revenue generated by these operating overrides and the use of general funds to subsidize the SWEF. The operating overrides were property tax increases dedicated specifically for the SWEF. Property taxes have been dedicated to support landfill operations instead of implementing user fees. General fund revenues, which are comprised mainly of property tax revenues, state aid, and local revenue, support the operations of the School and the Town. In fiscal 2010, property taxes dedicated to the SWEF are providing $2.78 million in revenue for the fund. Over $1.4 million in general fund revenues are being used to subsidize the SWEF, and $500,000 in free cash is being used to pay for landfill mining.

Unlike most towns, Nantucket does not have a user fee for residents by requiring the purchase of a landfill sticker. There are benefits to dedicating property tax revenues to support landfill operations, which are outlined below, rather than implementing a user fee. Nantucket has been able to take advantage of these benefits because of its unique situation as an island. In addition to providing revenue, a landfill sticker helps to control access to a landfill. However, ensuring users of the landfill are residents of the Town is not a need on Nantucket.

Advantages: Dedicating property tax revenue to support the SWEF is less regressive than implementing a sticker fee, which is illustrated by the chart attached to this memorandum. Identifying $2 million in new revenue for the SWEF through an operating override will cost a single homeowner with a home valued up to $2 million less than generating the same amount of revenue through the implementation of a sticker fee.

In addition to being less regressive, using property taxes rather than a fee provides a tax benefit to residents. Property taxes are tax deductible from the federal income tax, but a sticker fee is not tax deductible.

Dedicating additional property tax revenue to the SWEF will not result in additional administrative costs or require additional personnel to administer.

Disadvantages: Property tax revenue does not grow as quickly as the cost of operating the landfill. The Waste Services Agreement (WSA), which is the contract for landfill operations, requires annual inflationary increases equal to the Consumer Price Index (CPI). From 1997 to 2008, the CPI for the Boston area increased on average 3.1% annually. Property tax revenue dedicated to the SWEF is limited by state law to grow no more than 2.5%.

In a given year, the difference between cost increases and revenue growth may be manageable. However, over time the difference between cost increases and revenue growth will result in a meaningful deficit. The more property taxes are used as a dedicated revenue source for the SWEF, the greater the potential for experiencing deficits in the out years. If property taxes are used to identify $2 million in revenue, then over a 5 to 7 year period the annual difference between property tax revenue growth and inflationary cost increases could accumulate to a $150,000 to $200,000 deficit.

Dedicating additional property taxes to support the SWEF requires voter approval, which presents a challenge from a budgeting perspective.

2. ***Implement New User Fees***

As previously indicated, Nantucket is unique in that it does not require the purchase of a landfill sticker to use the landfill. Requiring the purchase of a landfill sticker to use the landfill would implement a new user fee. In fiscal 2011, to generate $2 million in revenue would require a sticker fee of approximately $228.

An alternative to a general landfill sticker fee could be a sticker fee implemented for certain cost centers. Nantucket has recently received national attention for its high recycling rate, which appears to be the highest rate of recycling in the country. While this is a laudable achievement, it is costly to obtain such a high rate of recycling. As explained in the memorandum from CommonWealth Resource Management, the landfill has cost centers central to recycling that do not have a dedicated revenue stream sufficient to cover the cost of operations.

The Materials Recovery Facility (MRF) does generate some revenue from the sale of recyclable materials. However, this is a variable revenue stream that at best could provide funding for about 10% of the cost of operating the MRF. There is no dedicated revenue stream for Take It or Leave It.

A recycling fee could be implemented to cover the cost of operating the MRF and Take It or Leave It.

Advantages: A user fee such as a sticker fee would create a funding mechanism, similar to sewer rates for the Sewer Enterprise Fund, which could be adjusted as needed. A sticker fee could be increased as necessary to ensure revenues keep pace with increasing operating costs.

A user fee provides a better understanding of the cost to provide services than generating revenue through property taxes. A user fee will increase as costs increase, which could provide an economic incentive to reduce waste generation. This has been experienced with the Sewer Enterprise Fund, which has seen sewer flows decline as sewer rates have increased.

The statutory authority already exists to implement a sticker fee and does not require voter approval. From a budgeting perspective, implementing a sticker fee provides a greater degree of reliability in developing the fiscal 2011 budget.

Disadvantages: As previously discussed, implementing a new user fee through the implementation of a landfill sticker could be more costly for certain residents than by dedicating additional property tax revenue to the SWEF.

If a sticker fee is implemented, then administrative processes need to be implemented to issue the sticker. New administrative processes would need to include how to assess the sticker fee to haulers who provide private residential pickup for residents.

Additional personnel may be needed to administer the new process, and to monitor the landfill to ensure a sticker has been purchased by users.

Illegal dumping may increase more with the implementation of a sticker fee than increasing the amount of property taxes dedicated to the SWEF.

3. ***Adjust Existing Fees***
Existing fees and tip fees could be raised, including the assessment for restaurants and lodging establishments. As outlined in the CWRM memo, raising the tip fee for C&D material will probably not generate additional revenue because of the declining volume of C&D material handled at the landfill.

Advantages: Increasing existing fees could be done within existing processes.

Disadvantages: Increasing existing fees alone will not generate sufficient revenue to resolve the SWEF revenue deficit.

If tip fees are too high then waste streams may be diverted from the landfill, and high tip fees may also result in more illegal dumping.

4. ***Reduce School & Town General Fund Spending***
Since fiscal 2007, the general fund has increasingly been used to subsidize the SWEF. Prior to fiscal 2009, there were sufficient general funds to support Town and School operations and to provide a general fund subsidy to the SWEF. However, general fund revenue performance has been affected by the national recession. General funds can no longer support current School and Town services and operations as well as provide a growing subsidy the SWEF.

General fund spending for the School and Town could be reduced in order for the general fund to continue to provide a subsidy to the SWEF. For this to be a structural solution for the SWEF, reductions to School and Town spending would have to be permanent or ongoing.

The School and Town would need to reduce approximately 17 positions in order to provide $1,000,000 in general funds that could be used to support the SWEF. This assumes that the average cost of a position, including benefits, is $60,000.

Advantages: Permanent reductions to School and Town general fund spending would provide general funds that could be used to fund the SWEF.

Disadvantages: Permanent reductions to School and Town general fund spending will affect School and Town operations, and will require a reduction in services.

Implementing New Revenues

In fiscal 2011, the SWEF budget faces two distinct problems: (1) an operating deficit that is the result of insufficient revenue; and (2) unfunded state mandated capital costs. Revenue could be identified to address one or both of these problems.

In identifying revenue for the SWEF consideration needs to be given to the effect the current economy is having on residents. Identifying new revenue sufficient to eliminate the SWEF's structural deficit and pay for unfunded capital costs in fiscal 2011 could present a hardship to residents given the current recession. Developing a multi-year plan to resolve the SWEF deficit will help to mitigate this hardship. If a multi-year plan for addressing the SWEF's systemic revenue problem is developed, then it needs to be determined if revenue will be identified for operating or capital costs in fiscal 2011.

A capital or debt exclusion override could be sought for unfunded capital costs. Landfill mining will be required by the state through fiscal 2014. The annual cost of landfill mining is $550,000 a year for a total cost of $2.2 million. When landfill mining concludes, there will be additional capital costs for capping and closing unlined cells. An accurate estimate for the cost of capping and closing unlined cells cannot be developed until landfill mining is completed, but it is roughly estimated that it will cost between $5 and $5.5 million. In addition, in the next 2 to 4 years landfill cells that are currently being used will have to be capped and closed, and a new landfill cell will have to be constructed.

In determining whether revenue should be identified for capital or operating costs consideration needs to be given to the potential tradeoffs of identifying funding for one of the needs over the other. For fiscal 2011, free cash or one-time general fund spending reductions could be used to fund landfill mining so that in the short-term landfill mining will be funded. However, there is no alternative funding source other than the general fund to fund the operating deficit within the SWEF. Using the general fund to completely cover the operating deficit within the SWEF will require significant ongoing general fund spending reductions that will affect the operations of the School and Town. Based upon how severely School and Town operations will be affected by using general funds to cover the SWEF operating deficit, and that there is alternative funding available in the short-term for capital costs, identifying a revenue stream for operating costs is a more pressing need.

Identifying revenue to address the operating deficit for the SWEF should be the priority for fiscal 2011, with the expectation that revenue will need to be identified for unfunded capital costs in the out years.

SWEF Deficit – Additional Information

In its memorandum, CWRM identified the structural revenue problem with the SWEF's fiscal 2010 budget. The remainder of this memorandum provides additional information regarding the SWEF deficit, including the history of general fund subsidies to the SWEF.

SWEF Deficit History

The current structural imbalance of the budget for the SWEF began in fiscal 2006, when new state regulations (known as the "wood waste ban") prohibited putting Construction and Demolition Material (C&D) in the landfill. This change in state regulations increased landfill operating costs because thousands of tons of C&D waste had to be shipped off-island. As a result of these increased costs, revenues generated by SWEF activity could no longer support operating costs. In fiscal 2006, retained earnings in the SWEF were used to cover an operating deficit that was the result of these increased costs. Due to the structural imbalance of the SWEF, the use of retained earnings in fiscal 2006 was a one-time solution to balance SWEF budget.

The general fund began subsidizing the current SWEF deficit in fiscal 2007, when over $540,000 in general funds were used to balance the fiscal 2007 SWEF budget. At the time, the general fund was healthy and could support this level of subsidy without adversely affecting School and Town operations. In fiscal 2007 and fiscal 2008, the general fund subsidy was provided through the use of the reserve fund and by end of year budget transfers. However, by fiscal 2009 the SWEF deficit had grown to just under $1.5 million and the SWEF deficit could no longer be covered by use of the reserve fund or through budget transfers. In addition, a reduction in Town general fund spending in recent years has reduced the level of general funds that may be available for year end budget transfers.

In fiscal 2009, a Special Town Meeting directly appropriated $1.47 million in general funds to the SWEF. General funds for this appropriation were available as a result of the Health Insurance Drawdown. Due to a healthy fund balance in the Health Insurance Trust Fund, employer and employee contributions for health insurance were suspended for three months. General funds originally appropriated for health insurance benefits were re-appropriated to the SWEF and for other purposes. The Health Insurance Drawdown made it possible to balance the fiscal 2009 SWEF budget; however, as a one-time action it did not address the structural revenue problem within the SWEF.

In fiscal 2010, free cash and general funds are being used to provide funding for the SWEF. Free cash is being used to provide $500,000 for landfill mining. Reductions to Town and School general fund spending allowed for general funds to be used to cover the fiscal 2010 SWEF deficit. This includes the one-time action of not funding the 1% capital funding requirement, which allowed for approximately $640,000 in general funds to be appropriated to the SWEF to cover its fiscal 2010 budget deficit.

Causes of SWEF Deficit

There are four primary factors contributing to the current SWEF revenue deficit: (1) a lack of sufficient revenue dedicated to support landfill operations; (2) revenue declines caused by the economy; (3) state mandated legacy capital costs; and (4) costs growing faster than certain dedicated revenues.

1. <u>Lack of Sufficient Revenue Dedicated to Support Landfill Operations</u>
   CWRM has provided an overview of operating costs at the landfill that do not have dedicated revenue streams. Until fiscal 2006, when the state implemented a wood waste ban, tip fees collected on commercial C&D material provided revenue that cross-subsidized landfill operations. In other words, C&D tip fees generated more revenue than was needed to dispose of C&D waste. This revenue was used to fund landfill operations that did not have a dedicated revenue stream, such as the Materials Recycling Facility (MRF).

   As a result of the state wood waste ban, thousands of tons of C&D waste that had been deposited in the landfill had to be shipped off-island for processing. The cost of shipping C&D material off-island increased landfill operating costs, and decreased the margin between the tip fees paid for C&D material and the cost of disposing of C&D material. Prior to fiscal 2006, the margin between C&D tip fees and C&D processing costs was approximately $100 ton. This margin in C&D revenue was used to offset the lack of dedicated revenue for other cost centers at the landfill. Due to the increased shipping costs that resulted from the wood waste ban, the per ton margin went from approximately $100 per ton to $20 per ton, or a loss of $80 in revenue per ton that could be used to subsidize other operations of the landfill.

   In fiscal 2006, tip fees were paid on 11,176 tons of C&D waste. With a per ton margin of $100, this volume of C&D material would have generated $1,117,600 in revenue to support other operations of the landfill. However, due to increased shipping costs that resulted from the state wood waste ban this revenue stream decreased by 80%, or almost $895,000, to approximately $224,000.

2. <u>Volume Declines</u>
   A decline in building activity as well as the national recession has led to a decline in the volume of material handled at the landfill for which a tip fee is paid. A decline in volume does result in lower costs as less material is handled and shipped, but it also results in lower revenues. A net loss of revenue for the SWEF results when there is a decline in volume for materials that have tip fees that are higher than disposal costs, such as C&D material.

   In fiscal 2008, 9,350 tons of C&D waste for which a tip fee is charged was handled at the landfill. In fiscal 2009, the volume of C&D material that generates revenue declined by 29% to 6,640 tons.

   Due to a steep decline in commercial C&D volume, C&D activity no longer generates revenue that can be used to subsidize the cost of other services at the landfill. In fact, commercial C&D volume has declined to the point where commercial C&D tip fees no longer support the cost of handling all C&D waste. In fiscal 2009, 1,364 of "1827" waste handled at the landfill. 1827 waste is C&D waste for which a tip fee is not paid, but the full cost of handling 1827 waste is incurred. 1827 waste is C&D waste generated by: municipal departments; non-profit organizations such as the Land Bank and Conservation Commission; and residents. Commercial C&D volume must be significantly higher than the volume of 1827 waste in order for C&D tip fees to pay the cost of handling all C&D waste and generate revenue that can be used to pay for other costs at the landfill. Based upon year-to-date collections, an estimated 1,100 tons of 1827 waste will be collected at the landfill this year. Approximately 6,900 tons of commercial C&D waste would have to be collected to generate sufficient tip fee revenue to cover the cost of disposing of 1827 waste. However, based upon year-to-date collections, it is estimated that just over 4,500 tons of commercial C&D waste will be collected at the landfill in fiscal 2010.

The historic reliance on commercial C&D tip fees to support other operating costs of the landfill also appears to be contributing to the decline in C&D volume. C&D tip fees have consistently increased, and are currently $361.00 per ton. The cost per ton has increased to the point where generators of C&D material are finding lower cost alternatives for disposing of C&D waste, such as directly shipping off C&D waste.

It is likely that C&D volumes would have declined without material being diverted from the landfill or a decline in building activity due to the recession. Nantucket experienced a spike in building activity from fiscal 2004 through fiscal 2007. The building boom appears to have somewhat masked the structural revenue deficit within the SWEF. The tonnages of C&D material for which a tip is paid were 10% to 20% higher during the building boom. When the per ton margin for C&D material was $100 this meant C&D tip fees generated $100,000 to $200,000 more in revenue than could be expected during periods of normal building activity. The level of building activity in fiscal 2006 appears to have overstated the structural revenue loss to the SWEF that resulted by the wood waste ban by $100,000 to $200,000.

The national recession has also affected revenue generated from the sale of recyclable materials. In fiscal 2008, cardboard sold for $110 a ton. In fiscal 2009, it cost less to compost cardboard than to ship it off-island because the market for recycled cardboard declined so sharply.

3. <u>State Mandated Legacy Capital Costs</u>
The landfill operates under an Administrative Consent Order (ACO) with the Department of Environmental Protection (DEP). The ACO requires capital improvements at the landfill for the purpose of environmental protection. Initially, the ACO required the capping and closing of unlined cells. However, the ACO was amended in 2009, to allow for landfill mining over a five year period. Landfill mining will reduce the size of the unlined cells that have to be capped and closed, which will reduce the capital costs of capping and closing unlined cells.

In fiscal 2010, landfill mining is being paid for with free cash. A revenue source to pay for landfill mining for the remaining 4 years of landfill mining has not been identified. This unfunded legacy capital cost will cost $2.2 million from fiscal 2011 through fiscal 2014, or $550,000 a year. When landfill mining is completed, an estimated $5.5 million will be necessary to cap and close unlined cells. However, the cost of capping and closing unlined cells will not be known until the conclusion of landfill mining. These cost will depend upon the number of acres that need to be capped and closed. The current plan for landfill mining estimates that the footprint for unlined cells will be reduced from 22 acres to 15 acres.

Capital costs will also be incurred for the capping and closing of cells currently in use, and for the construction of a new lined cell. Funding for these capital costs has not been identified.

As an enterprise fund, the SWEF should generate sufficient revenue to cover operating and capital costs. Unfunded legacy capital costs are increasing the SWEF deficit. Through fiscal 2014, the cost of landfill mining will increase the SWEF deficit. Depending on when current cell capacity is used up, the capital costs for capping and closing currently used cells and building a new cell will also add to the SWEF deficit.

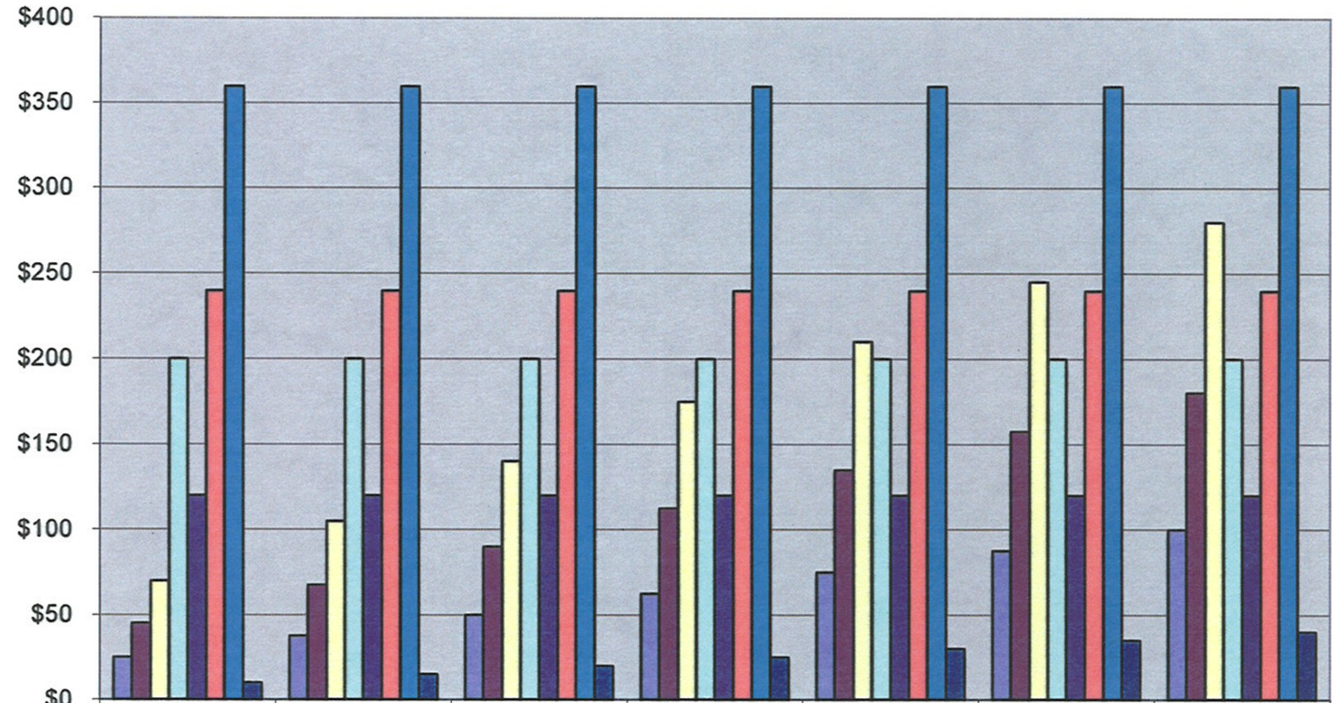
4. <u>Costs Grow Faster than Dedicated Revenues</u>
Two operating overrides have been passed to support the SWEF. In fiscal 2010, these overrides are providing $2,855,000 in property tax revenue that is dedicated to supporting the SWEF.

The revenue generated from the operating overrides may not grow faster than 2.5% per year. However, the Waste Services Agreement, which is the agreement with Waste Options Nantucket for landfill operations, requires increases equal to the Consumer Price Index (CPI). From calendar 1997 to 2008, the annual average for CPI growth was 3.1%.

Property tax revenues dedicated to the SWEF have grown at a slower rate than the contractually required inflationary increases. On average, costs tied to the CPI have grown 0.6% faster than a portion of revenues used to support those costs. As costs increase faster than revenue over time a deficit will naturally occur.

Cc: Jeff Willett, Director, Department of Public Works
Connie Voges, Director, Finance Department
Finance Committee Members

FY 2011 Solid Waste Fund Revenue Options and Impact to Residential Tax Bills

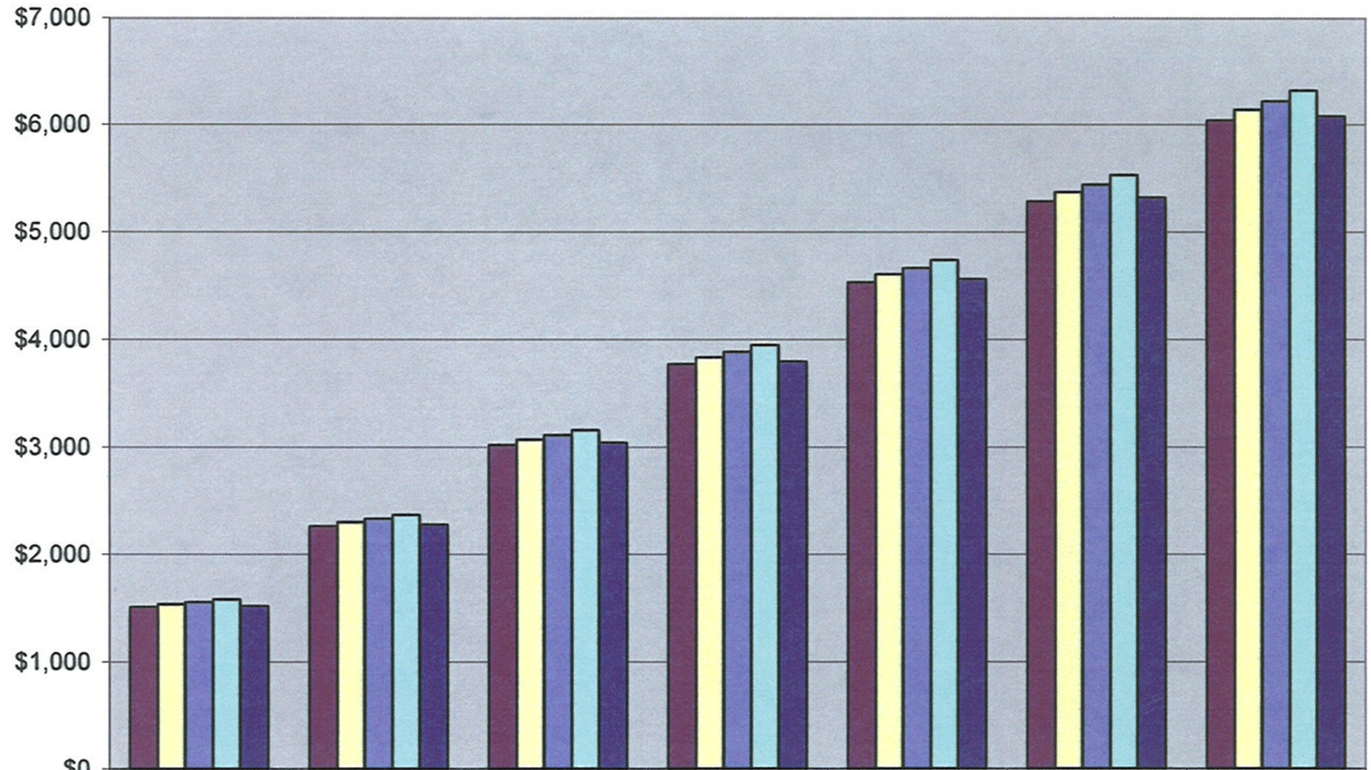


	$500,000	$750,000	$1,000,000	$1,250,000	$1,500,000	$1,750,000	$2,000,000
Dollar Cost of 1 Million $$ Override	$25	$38	$50	$62	$75	$88	$100
Dollar Cost of 2 Million $$ Override	$45	$68	$90	$113	$135	$158	$180
Dollar Cost of 3 Million $$ Override	$70	$105	$140	$175	$210	$245	$280
Reinstate Residential LandFill Fee	$200	$200	$200	$200	$200	$200	$200
1 Million From Sticker Fees	$120	$120	$120	$120	$120	$120	$120
2 Million From Sticker Fees	$240	$240	$240	$240	$240	$240	$240
3 Million From Sticker Fees	$360	$360	$360	$360	$360	$360	$360
Capital Expenditure $550,000	$10	$15	$20	$25	$30	$35	$40

Prepared by D.Dilworth 11/12/09

Sticker Fee estimates based on FY 10 Residential parcel count of 8342

FY 2011 Estimated Costs SWEF Override



	$500,000	$750,000	$1,000,000	$1,250,000	$1,500,000	$1,750,000	$2,000,000
FY 11 Tax Bill (TB) Base	$1,510	$2,265	$3,020	$3,775	$4,530	$5,285	$6,040
TB with 1 Million $$ SWEF OR	$1,535	$2,303	$3,070	$3,838	$4,605	$5,373	$6,140
TB with 2 Million $$ SWEF OR	$1,555	$2,333	$3,110	$3,888	$4,665	$5,443	$6,220
TB with 3 Million $$ SWEF OR	$1,580	$2,370	$3,160	$3,950	$4,740	$5,530	$6,320
Tax Bill with $550,000 Cap. Exp.	$1,520	$2,280	$3,040	$3,800	$4,560	$5,320	$6,080

Prepared by: D. Dilworth 11/12/09